

9 Programme Declaration of the New Government

9.1 The Medium-Term Objectives of Budgetary Policy

The government's objectives in its programme declaration are: (a) to reverse the unfavourable development of public finances, especially in the area of mandatory expenditures, (b) to reduce the general government deficit, (c) to halt government debt growth, (d) to reduce unemployment and the tax burden, and (e) to reduce the level of corruption and regulation. Fiscal consolidation and a change in the structure of expenditures, especially in the mandatory area, will also improve the quality of public finances.

These strategic objectives, however, will not be incorporated into the legislative steps until this year and next year, thus the government's objectives presented here are without quantification.

The programme declaration contains fiscal objectives expressed in the national methodology, which is cash based. The government plans to gradually reduce the general government deficit to 3.0% of GDP in 2008, to 2.6% of GDP in 2009 and to 2.3% of GDP in 2010. Since some of the planned measures on the revenue side will have a different impact in cash and accrual terms, the deficit may be approximately 0.2 of a percentage point higher in subsequent years according to ESA 95 methodology.

The government has explicitly adopted the principles of fiscal targeting and medium-term expenditure frameworks. It has committed itself to submit the medium-term fiscal outlook, which respects these principles and the Czech Republic's international obligations vis-à-vis the EU.

In this respect, it responds to the deficiencies identified in the last National Reform Programme (2006) and as a part of the preparations for the 2007 state budget and its medium-term outlook (see Sections 4 and 8). With respect to the maximum deficit level, the maximum nominal amount of expenditures will be set on the basis of macroeconomic assumptions and the related budgetary revenue forecasts. The obligation to meet the medium-term expenditure framework will be supported by the following principle: in the event of higher-than-expected revenues, expenditures will be the indicator not to be exceeded; if revenues are lower, then the deficit will be the indicator not to be exceeded.

Fiscal consolidation will rely to a substantial degree on the consolidation of the expenditure side of public finances through halting the growth of expenditures, especially social expenditures. The main instruments should be a moratorium on adopting acts that increase mandatory expenditures and a reduction in the share of mandatory expenditures in the state budget for 2010 to under 50% (from the 54.7% budgeted for 2007).

Expenditure-based consolidation leads to a reduction in the deficit and a gradual decline in the composite tax quota, which should fall to under 34% of GDP by 2009 according to the national methodology (against 37% in 2007).

As for the long-term financial sustainability of public finances, the government's main priority is to initiate reforms of the pension and healthcare systems.

9.2 Measures on the Expenditure Side

The main instrument for public budget consolidation and for reaching the set budgetary objectives is to slow the growth of mandatory expenditures, especially social expenditures. In its programme declaration, the government undertakes to regulate the development of mandatory social expenditures, which make up about 80% of total mandatory expenditures in the 2007 state budget. The goal is to keep the public finance deficits from exceeding the set targets and to keep total mandatory expenditures in 2010 below 50% of the state budget.

In particular, the government intends to implement the following austerity measures:

- A moratorium on adopting acts that increase mandatory expenditures;
- Removing the automatic valorisation schemes, with the exception of pensions;
- Reducing the number of civil service employees by at least 3% p.a. by 2010;
- Changing the conditions for providing social contributions and reducing the amount and reassessing the provision of additional benefits with the goal of increasing transparency and directness;
- Changing the system of sickness insurance by introducing a three-day exclusion period²¹, reducing the percentage rate for wage compensation and sickness benefits, and introducing a reduction in the daily assessment base;
- Introducing flexible parental and maternity leaves with payments that gradually decrease over time and with an age limit of three years old for the children;
- Assessing the connection between the disbursement of funds from the social system and the obligation of requalification, community work, and participation in further education projects;
- Eliminating the lack of motivation to earn caused by the incremental limits for receiving social benefits so that the marginal net rate of taxation is as linear as possible;
- Postponing the approved system of social casualty insurance for one year and creating a new system without encumbering the state budget.

9.3 Measures on the Revenue Side

A change in the trends of mandatory expenditures, together with a change in the quality of the expenditure structure, helps to gradually reduce the tax burden and to shift its structure towards indirect taxation. The following key measures will be taken:

²¹ During which sickness benefits are suspended.

Income tax

- A flat income tax rate for private individuals and legal entities from 17% to 19% together with allowances for families with children and low-income groups;
- To perform an audit of exceptions and deductible items for the income taxes of private individuals and legal entities with the goal of verifying the need of these in the future, to significantly reduce the number of exceptions and deductible items;
- To simplify the system of accounting depreciation, especially for small organisations;
- To promote investment in science, research and environmentally friendly technology;

Value added tax

- The standard VAT rate will be from 17% to 19%;
- In addition to reducing the standard VAT rate, the reduced rate will be changed so that it is also acceptable for socially weak groups;
- The reduced VAT rate will be calculated separately and certain environmental fuels and technology, among others, will be included;

Additional tax measures

- Cancellation of taxes on dividends, capital earnings, inheritance, gifts (with the exception of persons who are not relatives), real estate transfer tax, and real estate tax on agricultural land;
- Cancellation of the minimum tax for self-employed;
- Possibility of one-year tax holidays for self-employed.

Environmental tax reform

In accordance with EU requirements and the Czech Republic's commitment, an environmental tax reform will be implemented. A new energy tax (tax on electricity, coal and natural gas) will be introduced starting from January 2008. During the first phase, tax rates will be set at the level of the minimum tax rates under European legislation. In the second phase, gradual increases in the rates may be considered.

Social insurance

The government plans to adopt the following measure in the area of social insurance:

- To reduce the social contribution rate in line with environmental tax revenue;
- To reduce the assessment base for the social security and health insurance contributions for self-employed to 35%;
- To introduce a maximum assessment base (ceiling) for contributions;
- With respect to the new act on sickness insurance (see Section 6.2), to allow firms with up to 50 employees to opt for a partial refund of earnings for wage compensation from the state budget without reducing the social security contributions.

Tax administration

The government would like to significantly reduce the administrative burden of business by simplifying and streamlining the administration of taxes and social security contributions. Thus, the number of offices for tax and contribution collection will be reduced, the project of central registration offices will be completed, and a duty to provide binding interpretations of tax regulations will be introduced. In addition, the government would like to prevent tax evasion, strengthen motivation for paying taxes, and increase tax revenues. The government intends to submit a proposal for cancelling the obligation to introduce registration desks. It will also introduce a system of “super-gross” wages as current gross wages plus deductions for health and social security contributions paid by employers.

Other revenues

Another objective of the government is to complete the privatisation process. The government plans to privatise Czech Airlines, the Prague Airport and the Czech Post Office and to review the partial privatisation of Czech Railways. The value of the shares of ČEZ should be incorporated into the pension reform. The incorporation of revenues from privatisation into state expenditures should be completed with the 2009 budget at the latest.

The system of electronic motorway tolls in the Czech Republic for vehicles over 12 tonnes was put into operation on 1 January 2007. The next step will be to combine it with microwave and satellite technology for collecting tolls on all motorways and certain first class state roads for vehicles over 3.5 tonnes. The government will have discussions with the regions with the goal of expanding the toll system for second class or possibly even third class roads. Toll rates will differ according to vehicle emission parameters to the maximum extent permitted by EU legislation.

With respect to the priorities identified in the last CP (see Section 8.2), the government plans to simplify the system of allocating European funds and to create a clear and unified system for informing the public. It will prepare a system of co-financing the structural fund programmes and the Cohesion Fund from national public sources that will ensure maximum possible access to the programmes for all relevant agents of regional development.

9.4 Long-Term Sustainability of Public Finances

In addition to the medium-term consolidation of public finances, the main priorities of the new government are pension and healthcare reforms. Changes in the pension system and healthcare system will be based on maintaining the principles of solidarity, increasing individual responsibility and supporting families with children.

Pension reform

In the first stage of the pension reform, parametric changes to the pay-as-you-go system will be made, including the ongoing process of raising the retirement age to 65 years old, extending the minimum insurance period to 35 years, introducing a maximum assessment base (ceiling) for contributions, introducing a flexible age band for retirement, and additional changes with respect to the preliminary agreement between the political parties from the beginning of 2006.

The second stage of the pension reform will involve the separation of client and shareholder assets in the system of voluntary pension schemes, including the option of providing various targeted pension plans, including guaranteed plans. Moreover, there will be an increase in motivation for higher contributions to voluntary supplementary pension insurance, higher employer participation, support in drawing on life-time pensions from supplementary insurance, creation of a reserve pension fund, and creation of independent state budget headings for financing pension insurance. With respect to the environmental tax reform, its integration with pension financing will be resolved and the contribution rate will be reduced in proportion to the environmental tax revenue. Minimum incomes for pensioners will be guaranteed at the minimum sustenance level.

The third stage of the pension reform could involve the creation of an additional voluntary savings scheme for the pension system based on the opt-out principle.

Healthcare reform

The government considers economic stabilisation, modernisation and additional development of the healthcare system, based especially on public health insurance, to be one of its primary programme priorities.

In this respect, it will initiate a discussion on the transformation of the healthcare system and the creation of an expert committee under the direction of an independent coordinator (similar to the expert team for the pension reform). However, until this time, it will adopt needed institutional and legislative changes on the basis of the following principles:

- Maintaining solidarity in healthcare financing;
- Strengthening the status of patients in the healthcare system on the basis of solidarity between healthy persons and patients;
- Strengthening fair competition among healthcare institutions and the status of physicians, the equal status of healthcare facilities regardless of ownership and legal form and replacing the act on non-profit hospitals in the EU environment with a standard act on non-profit organisations;
- Transforming health insurance companies into joint-stock companies with increased transparency;
- Revising the scope of health insurance with clear definitions of healthcare requirements and the possibility of choosing alternative health insurance with the option of paying extra for higher standard care or arranging supplementary insurance for this care;
- Introducing the transparent and effective payment of medication and medical supplies;
- The healthcare system as one of the priorities in the operational programmes for drawing on the EU structural funds.

The government plans to implement these measures during its elected period up to 2010. The measures will be specified in more detail in the draft state budget for 2008 and in the next CP update.